November 30, 2016 – Finishing Touches

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Based upon the continuing data flow, it still appears to me that we are close to the end of the downward price/market structure cycle in COMEX gold and silver. Of course, the data are always objective, while their interpretations are always in the eye of the beholder. Recognizing the difference, let me highlight the data, give my opinion on what they mean and then leave it up to you to decide if it makes sense.

I suppose there is subjectivity involved in which data sources one chooses, but in my case it's straightforward in that I'm only interested in data that are public and verifiable. Since I contend that price is primarily driven by futures contract positioning on the COMEX and the premier data source measuring that positioning is the Commitments of Traders (COT) Report, a very public and remarkably reliable source, that explains my focus on this report. And once you make the COMEX positioning connection, it's natural to analyze other public data involving the COMEX, such as physical warehouse stocks and movements, as well as deliveries against futures contracts.

Today was the first notice of delivery day for the big December COMEX gold and silver futures contracts. A delivery against a futures contract involves a change in physical ownership, in which the former owner of the physical metal gives up ownership for full cash payment. The ownership transferal may or may not involve future physical movement as that is up to the new owner. More than perhaps any other single factor, it is the transparent delivery mechanism for converting futures contracts into physical metal and vice versa, that gives the COMEX the legitimacy required to become the world's leading precious metals exchange. Other factors make the COMEX a cesspool, not its physical delivery process.

COMEX gold deliveries have been on the heavy side this year since April and today's delivery of 4938 contracts (493,800 oz) fits that profile. The first delivery day typically sets the tone for the rest of the month, but surprises are always possible. Based upon the first delivery day, December is shaping up to be within the parameters of recent traditional COMEX delivery months Â? not as heavy as June and August, but not light. I do think that the heavier COMEX gold deliveries this past eight months suggests accumulation by large entities, which I can't prove; although some hints point that way in terms of who is making and taking delivery.

This month the big gold issuers were Macquarie Futures (2991) in its house account and Goldman Sachs (1760) in its customer account. Macquarie originally showed up, for the first time, as a large stopper (taker) of gold deliveries in August and today's large issuance looks related to that, namely it disposing of gold it had recently acquired, although not enough information is available to speak in more definitive terms. The largest gold stopper was HSBC (1210 contracts), followed by a customer of JPMorgan (1187) and JPM in its house account (492) was the third largest gold stopper. The one subjective takeaway I have is that JPMorgan and its customer(s) continue to acquire physical gold and that is where to look for big entities accumulating the metal.

http://www.cmegroup.com/delivery_reports/MetalsIssuesAndStopsYTDReport.pdf

First day silver deliveries were somewhat light at 717 total deliveries, with Goldman the big issuer (528) in its customer account, with the metal having been stopped in recent months, making the delivery looking like a one off. Macquarie was the biggest stopper (250) by a nose, with JPMorgan stopping 237 contracts, also in its house account. I'm not sure what Macquarie is up to, but it looks clear that JPM is continuing its physical silver acquisition ways. It seems if there is one thing you can set your watch to it is that JPMorgan has been steadfast in acquiring physical silver. And my only explanation for why it doesn't demand even more silver at this time is because to do so would jolt the price upward.

A subscriber asked me recently if I could prove JPMorgan held the 550 million oz I claim it holds by identifying the silver it held, away from the 81 million oz in its COMEX warehouse. The answer is not just no, but hell no – I couldn't prove it if my life depended upon it. In fact, I couldn't certify that JPM even owns the metal in its COMEX warehouse, as it might be holding it for a different owner. So, in reality, I can't point to one ounce that JPMorgan holds for certain. That's one of the key benefits of owning physical metal Â? held in the correct form, it provides complete anonymity; a fact surely not lost on JPM.

But I can assure you that my contention about JPMorgan holding 550 million oz of physical silver has never been stronger based upon every silver data point I have observed over the past five years and longer. And I am fully prepared to be judged on my contention, just as I've been prepared to be judged on every previous contention I've ever made, including the original revelation that silver (and gold) were manipulated in COMEX dealings. The truth is that I feel extremely fortunate to have discovered JPMorgan's physical silver acquisition binge and whether anyone agrees with me is a separate matter.

Still, the subscriber's question was highly legitimate, as was his corollary question Â? would I still be as bullish on silver if JPM didn't own the physical silver I claim? That's a lot more difficult to answer, precisely because I'm so convinced it does own the metal. But speaking in the abstract, it certainly wouldn't be bearish if JPMorgan didn't hold as much silver as I claim for the simple reason it couldn't dump the metal on the market. This was the leading bearish argument I heard from many who accepted my contention that JPMorgan owned the metal I claimed, but differed as to what it portended for price. Many worried that JPM would use the metal to continue the manipulation indefinitely. Should JPMorgan hold no physical metal, there would be no metal to dump.

At a minimum, however, it's almost impossible that JPMorgan doesn't own enough physical metal to at least cover its now recently reduced COMEX silver paper short position. While I still believe JPM is set for the financial score of the ages when silver does run; I was always fully prepared for its eventual profits to remain hidden from public view. I never expected that the bank would ever reveal its silver master play and I won't be disappointed if it remains hidden. That's just the way it is.

With yesterday's reporting week cutoff behind us, it's time to consider what Friday's COT report will reveal. This week's report will include the very sharp engineered price decline accompanied with heavy trading volume over the Thanksgiving holiday. Rather than simply make a contract number prediction, let me first give you the variables as I see them. Given the sharp price takedown and the manner in which it occurred, it is certain that the managed money traders were selling and the commercials were buying in gold and silver, with the only real question being how much?

Other inputs indicate a sharp reduction in total open interest over the reporting week, in which total open interest in gold declined by 55,000 contracts and by 13,000 contracts in COMEX silver. Such large drops normally indicate a large drop in the commercial total net short position of somewhat equivalent amounts. Complicating matters this time around is that the reporting week included the last week before the start of the big December delivery periods, when a very large number of contracts are involved in rollovers from December to more distant months. On paper, rollovers have no bearing on positioning, because net positions don't change as a result of a contract rollover.

But since rollovers are executed on a spread basis, namely, the simultaneous purchase and sale of the same commodity in different months, the rollover period immediately preceding a big first delivery day is the most active time for spread transactions. Since spread liquidity is most intense at this time, the enhanced spread liquidity invites other spread activity and it is possible to liquidate a large number of spreads without much price slippage at such times. Therefore, the large drop in total open interest in COMEX gold and silver in the reporting week to be disclosed Friday may be related to spread liquidation and not big net positioning changes.

Regardless of potential spread liquidation, I would still expect significant reductions in the total commercial net short positions to be reported Friday, say on the order of 30,000 contracts or more in gold and 5000 contracts or more in silver, with hopes highest on the more or the much more. Friday's report will also include the third installment of the managed money short selling drama, which I've already identified as a very big deal. You can be sure this will be a key feature for me in this report, along with how many short contacts the big 4 (read JPMorgan) bought back in gold and silver. The big reduction in total open interest over the reporting week also suggests no big buildup in managed money short positions, but late Friday will set all speculation to rest.

It's safe to say that I believe the finishing touches are being applied to the bullish setup in gold and, particularly, in silver. The main component of the bullish setup is the current market structure on the COMEX, which is at the most bullish readings for gold and silver since very early in the year. Today's price swoon only strengthens the market structure. Gold was sliced to a new price low by a few dollars on pretty heavy volume, suggesting new managed money selling and commercial buying after yesterday's cutoff. Silver is lower as well, but hasn't established the fresh lows seen in gold.

There's no question that the market structure is still improving, but the big question is how much more to go? I still think there's not much more to go, but that will only be known in hindsight, after the price bottom has been recorded. In the interim, new prices lows can be made. Also, even if we are at or close to the bottom (as I believe), there is no way of determining in advance how long before the rally begins. Given all the facts and what's transpiring in other markets, it wouldn't seem the wait for a rally in gold and silver would be terribly long. More important, of course, is the nature and extent of the coming rally and the current low level of risk in holding silver positions.

It is conceivable and possibly highly so, that I am way too early in my assessment that the market structure has been sufficiently flushed and, instead, there is much more to go. In that case prices could move substantially lower from here and please accept my apologies in advance if that turns out to be the case. When gold and silver prices and commercial short positions were much higher this summer, I remember silently wishing for just one more bullish setup in which prices and commercial short positions were much lower. It took a while and even if there's a bit more to go in terms of price and time, I have to admit that I got my wish. Since the capacity to wish is inexhaustible, now I'm wishing it was over already; but I'm still most grateful that I got my main wish.

Ted Butler

November 30, 2016

Silver – $16.50   (200 day ma – $17.66, 50 day ma – $17.89)

Gold – $1174   (200 day ma – $1281, 50 day ma – $1267)

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